

§ 1.121-3

26 CFR Ch. I (4-1-03 Edition)

full years, 1998 and 1999. A buys a house in 2000 that he owns and uses as his principal residence. A sells the townhouse in 2002 and excludes gain realized on its sale under section 121. A sells the house in 2003. Although A meets the 2-year ownership and use requirements of section 121, A is not eligible to exclude gain from the sale of the house because A excluded gain within the last 2 years under section 121 from the sale of the townhouse.

(c) *Effective date.* This section is applicable for sales and exchanges on or after December 24, 2002. For rules on electing to apply the provisions of this section retroactively, see § 1.121-4(j).

[T.D. 9030, 67 FR 78361, Dec. 24, 2002]

§ 1.121-3 Reduced maximum exclusion for taxpayers failing to meet certain requirements.

(a) *In general.* In lieu of the limitation under section 121(b) and § 1.121-2, a reduced maximum exclusion limitation may be available for a taxpayer who sells or exchanges property used as the taxpayer's principal residence but fails to satisfy the ownership and use requirements described in § 1.121-1(a) and (c) or the 2-year limitation described in § 1.121-2(b).

(b) through (f) [Reserved]. For further guidance, see § 1.121-3T(b) through (f).

(g) *Computation of reduced maximum exclusion.* (1) The reduced maximum exclusion is computed by multiplying the maximum dollar limitation of \$250,000 (\$500,000 for certain joint filers) by a fraction. The numerator of the fraction is the shortest of the period of time that the taxpayer owned the property during the 5-year period ending on the date of the sale or exchange; the period of time that the taxpayer used the property as the taxpayer's principal residence during the 5-year period ending on the date of the sale or exchange; or the period of time between the date of a prior sale or exchange of property for which the taxpayer excluded gain under section 121 and the date of the current sale or exchange. The numerator of the fraction may be expressed in days or months. The denominator of the fraction is 730 days or 24 months (depending on the measure of time used in the numerator).

(2) *Examples.* The following examples illustrate the rules of this paragraph (g):

Example 1. Taxpayer A purchases a house that she uses as her principal residence. Twelve months after the purchase, A sells the house due to a change in place of her employment. A has not excluded gain under section 121 on a prior sale or exchange of property within the last 2 years. A is eligible to exclude up to \$125,000 of the gain from the sale of her house ($12/24 \times \$250,000$).

Example 2. (i) Taxpayer H owns a house that he has used as his principal residence since 1996. On January 15, 1999, H and W marry and W begins to use H's house as her principal residence. On January 15, 2000, H sells the house due to a change in W's place of employment. Neither H nor W has excluded gain under section 121 on a prior sale or exchange of property within the last 2 years.

(ii) Because H and W have not each used the house as their principal residence for at least 2 years during the 5-year period preceding its sale, the maximum dollar limitation amount that may be claimed by H and W will not be \$500,000, but the sum of each spouse's limitation amount determined on a separate basis as if they had not been married. (See § 1.121-2(a)(3)(ii).)

(iii) H is eligible to exclude up to \$250,000 of gain because he meets the requirements of section 121. W is not eligible to exclude the maximum dollar limitation amount. Instead, because the sale of the house is due to a change in place of employment, W is eligible to claim a reduced maximum exclusion of up to \$125,000 of the gain ($365/730 \times \$250,000$). Therefore, H and W are eligible to exclude up to \$375,000 of gain ($\$250,000 + \$125,000$) from the sale of the house.

(h) [Reserved]. For further guidance, see § 1.121-3T(h).

(i) through (k) [Reserved].

(l) *Effective date.* This section is applicable for sales and exchanges on or after December 24, 2002. For rules on electing to apply the provisions of this section retroactively, see § 1.121-4(j).

[T.D. 9030, 67 FR 78361, Dec. 24, 2002]

§ 1.121-3T Reduced maximum exclusion for taxpayers failing to meet certain requirements (temporary).

(a) [Reserved] For further guidance, see § 1.121-3(a).

(b) *Primary reason for sale or exchange.* In order for a taxpayer to claim a reduced maximum exclusion under section 121(c), the sale or exchange must